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World Economic and Social Survey 2010: Retooling Global Development

Overview

Summary

The global economic crisis, coming on top of the food, fuel and climate change crises, has exposed the systemic weaknesses that led to the crisis and which the international community must find ways to overcome. These systemic weaknesses derive from the incoherence between the present set of institutions and rules, which were established more than 60 years ago, together with the founding of the United Nations and related institutions, and the much more extensive economic interdependence and complexity induced by decades of globalization. Reshaping global mechanisms and strengthening national capabilities in support of the shared goal of poverty reduction and development offer a feasible path towards overcoming these weaknesses and achieving policy coherence within the global economy.

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Globalization at a crossroads

The global economic crisis of 2008-2009 exposed systemic failures in the workings of financial markets and major deficiencies at the core of economic policymaking; and the rapid spread of the financial fallout in the United States of America throughout nearly the entire world, affecting jobs and livelihoods, underscored the interconnectedness of the global economy. Moreover, the economic and financial crisis came on top of several other crises. Skyrocketing but highly volatile world food and energy prices reflected a decades-long neglect of food agriculture and failure to reign in increasingly speculative energy markets. Climate change is already a clear and present danger whose consequences are being felt in many parts of the world in the form of more frequent and severe droughts and excessive rainfall; its effects are compounding the other crises.

These multiple dramas have unfolded simultaneously and have exposed major weaknesses in our mechanisms of global governance for facing up to these challenges. While the strong desire for quick economic recovery is understandable, getting "back on track" would mean returning to an unsustainable path of global development. Sustained and widespread future prosperity will require major reforms in global economic governance and new thinking about global economic development.

A central concern of the new thinking will be the need for a focus on sustainable development — entailing an approach that would balance material wealth improvements with protection of the natural environment and ensure social equity and justice — rather than a focus narrowly concentrated on economic growth and private wealth generation based on market incentives. Global solutions will be required for global problems and, given the interdependence of these problems, policy responses will need to be highly coherent at various levels if the international community is to achieve the multiple objectives associated with fair and sustainable global development. Because of the complexity of global challenges, pursuit of these solutions will not be easy; it will require a new kind of thinking and the striking of a new balance between decision-making processes at the national level and those at the global level.

Retooling global development along these lines is the main theme of this year's *World Economic and Social Survey*. The study does not pretend to offer a blueprint; it aims instead to present ideas that could become the basis of a new, coherent "toolbox" for guiding development policies and international cooperation.

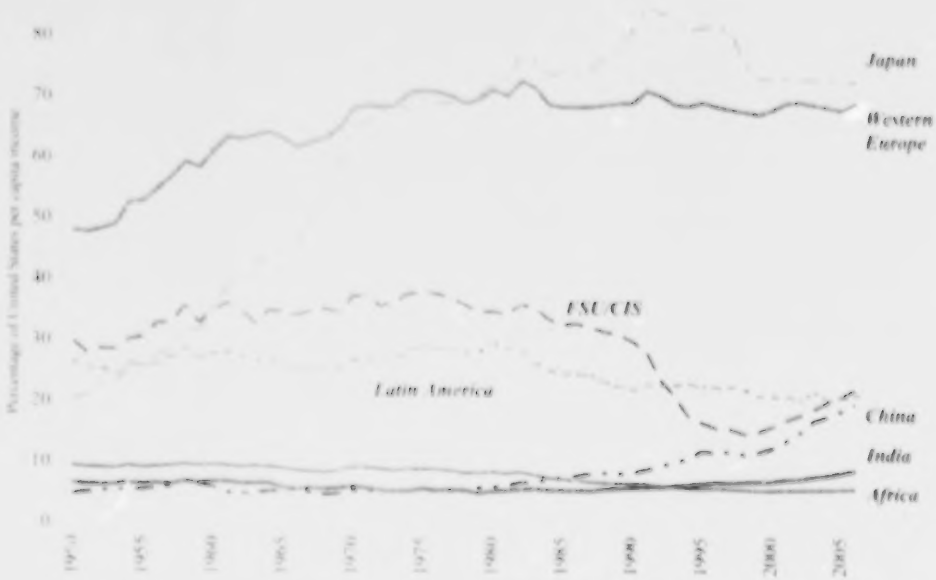
Times are changing

The present challenges emerge at a time that may well represent a watershed in history. Four major changes in the global economy are likely to be dominant in the foreseeable future.

First, there are important shifts taking place in the global economy. The rapid growth in developing Asia that is shifting the balance of global economic power is likely to continue. At the same time, while quite a few developing countries (mostly in Asia) have experienced a significant "convergence" towards the living standards of the now advanced countries, others, especially in Africa, have fallen farther behind (figure O.1). The number of the poor in the world living on less than $1.25 a

day decreased from 1.8 billion in 1990 to 1.4 billion in 2005, but nearly all of this reduction was concentrated in China. In sub-Saharan Africa and South Asia, the absolute number of the poor increased (figure O.2). At the same time, with few exceptions, income inequalities within countries have increased since the early 1980s. Redressing this trend in global economic divergence, so as to prevent its becoming a source of new tensions and insecurity, will be a major challenge in the decades ahead.

Figure O.1
Persisting global income divergence,[a] 1950-2007



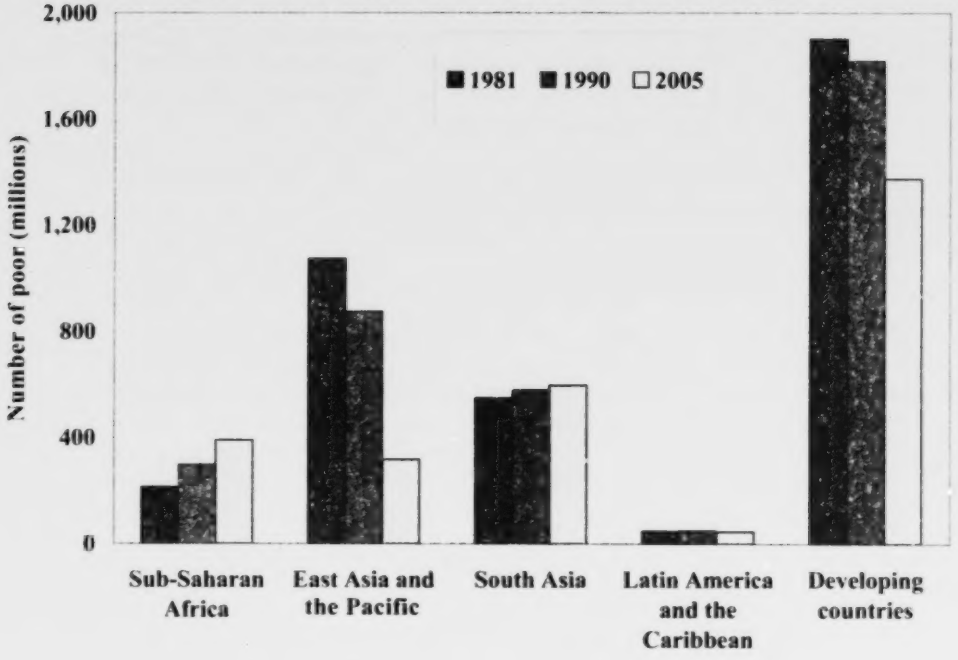
Source: Angus Maddison, "Statistics on world population, GDP and per capita GDP, 1-2006 AD" (2008). Available from http://www.ggdc.net/maddison/Historical_Statistics/horizontal-file_09-2008.xls.

Note: FSU/CIS = Former Soviet Union/Commonwealth of Independent States.

[a] As measured by country or regional income per capita as a proportion of that of the United States of America. Original values were measured in 1990 international Geary-Khamis dollars.

Second, demographic changes in the coming decades will strongly influence increasing global interdependence. More than 70 million people are added to the world's population every year. This means that, by 2050, the global economy would need to be able to provide a decent living for more than 9 billion people, of which 85 per cent will be living in developing countries (figure O.3). Progress in human development worldwide has helped to drastically reduce mortality rates and allow people to live longer. As a result, the world population is ageing rapidly. By 2050, 1 in 4 persons living in developed countries, and 1 in 7 in what are now developing countries, will be over 65 years of age. This will put pressure on pension and health systems. Further, the presence of declining and ageing populations in developed regions may result in much larger migration flows than occur today.

Figure O.2
Diverging trends in poverty reduction,[a] 1981, 1990 and 2005



Source: *Report on the World Social Situation: Rethinking Poverty* (United Nations publication, Sales No. E.09.IV.10).

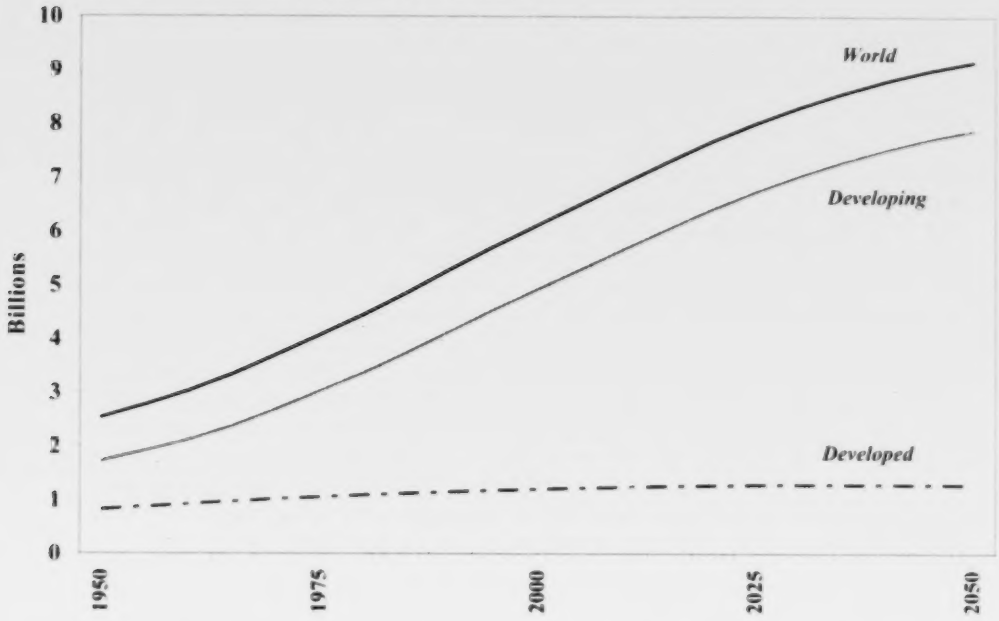
[a] Poverty being measured as the absolute number of persons living on less than $1.25 per day.

Developing countries will have to adapt to growing urban populations. By 2050, 70 per cent of the world's population is projected to live in urban areas and mega cities undergoing further growth will create problems of their own. This will make the creation of a sufficient number of decent jobs more challenging and, if the challenge is left unaddressed, persistent widespread poverty and inequality among urban-dwellers will be sources of social and political instability. That fact that larger urban populations will also change food and land-use patterns has potentially vast implications. In addition to the decline in agricultural land, there will be a stark increase in the consumption of meat and dairy products, leading, if the phenomenon is not addressed in a timely manner, to land-use shifts and further deforestation, higher energy use, rising food prices and regional food shortages.

Third, the growing world population has been supported in part by the degradation of our natural environment. About one half of the forests that covered the Earth are gone, groundwater sources are rapidly being depleted, enormous reductions in biodiversity have already taken place and, through the burning of fossil fuels, about 30 billion tons of carbon dioxide are currently being emitted each year. Thus, greater prosperity for humanity has come with huge environmental costs having global consequences. The threat of climate change illustrates this and, as demonstrated by the analysis provided in the 2009 *World Economic and Social*

Survey, containing this threat will require major transformations of energy systems, industrial production processes and infrastructure.

Figure O.3
The growing world population, 1950-2050



Source: Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat, "World Population Prospects: The 2008 Revision Population Database". Available from http://esa.un.org/unpp (accessed 12 April 2010).

Fourth, economic processes are increasingly interconnected globally. Agricultural and industrial production is increasingly taking place through largely unregulated global value chains dominated by international companies. The global crisis has made clear how interconnected financial markets are and how quickly problems in one part of the system can cause shock waves elsewhere. Climate change and increasing migratory flows are challenges with global ramifications. Yet, the policies, rules and institutions established to govern these processes are mostly national, while global mechanisms are strongly compartmentalized. Without reform, tensions will grow between decision-making processes at the national level and those at the global level.

The question is how to reform the institutions responsible for global governance so as to make them better equipped to address these challenges coherently while allowing nations and people to have the space needed to determine their own destinies.

Shifting development paradigms

The post-war period has seen fundamental shifts in the thinking about the causes of growth and development. The current global crisis has unleashed another

wave of reactions entailing reconsideration of the conventional wisdom. In the 1950s and 1960s, development was perceived as requiring the leadership of Governments in lifting specific binding constraints on growth and development, for example, through public investments aimed at building infrastructure, trade protection and industrial policies designed to promote import substitution and develop entrepreneurial capacity, and through attracting development assistance in lifting foreign-exchange constraints.

Such policies certainly promoted economic growth, sometimes with sustained success, as in parts of Asia, but less successfully in many other instances. Cases of failure to create enterprises that could survive on their own after decades of State support, effectively overcome foreign-exchange constraints, and generate sufficient employment, led to reassessments of development policies and cooperation. The "basic needs approach to development", for instance, suggested reorienting Government intervention towards more direct support for employment generation and securing access for all to social services. Another approach argued for reconsideration altogether of a role for Governments in managing economic development. Governments were viewed as distorting markets through their interventions and poor management of public finances. In this context, development policies would need to become more concerned with macroeconomic stability and to rely much more on deregulated markets and private initiative not only in productive activities but also in the provisioning of social services. This approach, which became the dominant paradigm of the 1980s and 1990s, is commonly referred to as the "Washington Consensus", inasmuch as it reflected the policy approach of the multilateral institutions and decision makers based in Washington, D. C.

The United Nations Millennium Declaration, adopted by the General Assembly in its resolution 55/2 of 8 September 2000, embodied a rediscovery of the insight that market-based growth strategies were insufficient by themselves to solve the problem of widespread poverty and that well-functioning institutions and effective social policies were needed to ensure adequate provisioning of health care and education and to prevent social exclusion of many. The global food, energy and financial crises that exposed the systemic flaws inherent in the functioning of deregulated global markets required Governments to step in to address those crises — and in ways that dealt a blow to the conventional wisdom underpinning the Washington Consensus.

Globalization and national policy space

There are no simple recipes for development success. Clearly, none of the dominant paradigms in the realm of development thinking that have emerged over time can take credit for having served as blueprints for successful development. Sustained, rapid economic growth in a number of countries in Asia was held up in the 1980s and 1990s as exemplifying the success of the market-oriented, export-led development strategies advocated by the Washington Consensus. In reality, however, the development policies behind these growth successes, especially in their early stages, resembled much more the recipes associated with the dirigiste paradigm of early development thinking and were not unlike those that had, in earlier times, promoted modern development in Western Europe and Japan. These development policies involved, inter alia, agrarian reforms, investments in human capital, selective trade protection, directed credit and other government support for

developing industrial and technological capacity while exposing firms gradually to global competition.

What worked in certain contexts in the past may not work equally well elsewhere. For one thing, the world has become increasingly integrated and the space available to countries for jump-starting their development in relative isolation has become commensurately smaller. The increasing role of foreign direct investment (FDI) and global value chains in driving world production, trade and technology development has limited the scope for the wielding of old-style industrial policies by national Governments; and multilateral trading rules have imposed restrictions on domestic support measures for developing export industries. Further, freely flowing private capital flows have made macroeconomic stabilization much more challenging. Rules for intellectual property rights and quality standards have increased the cost for many developing countries of absorbing new technologies and becoming globally competitive. This does not mean that there is no policy space at all, but rather that the narrowed scope is posing much greater challenges to policymakers today. As discussed below, certain reforms of international rules, which do not conflict with global objectives such as safeguarding global public goods, could help widen margins; but even with those reforms, a high degree of determination and coherent efforts by national policymakers will still be required if development strategies are to succeed.

The future of the poverty agenda

Improving human welfare and eradicating poverty are ultimate objectives of development. The answers to the question how to achieve these objectives through national development policies have moved back and forth between more and less interventionist approaches associated with the shifts in development paradigms.

Trickling down

The modern growth strategies of the 1950s and 1960s assumed that promoting industrial development would accelerate aggregate welfare gains, which would trickle down to the poor through the expansion of formal sector employment and rising real wages. Social policy was seen as a fundamental part of the overall development strategy. In many developing countries, social policy included the widespread distribution of subsidies for goods and services, which not only provided income support, but also contributed to keeping wage costs low in support of industrial development. Urban workers in growing modern industrial sectors and in government services were also the main beneficiaries of expanding social security covering health risks and old-age income insecurity (through pensions), as well as of subsidized and State-provided education and health-care services aiming at universal coverage. Rural producers also received subsidies and other incentives to raise agricultural productivity. However, for the most part, the needs of the structurally poor were neglected by social policies in many developing countries; and, in practice, urban middle-income groups with a stronger voice benefited most in many societies.

Redistribution with growth

Disappointing results from the implementation of this strategy in terms of employment generation and poverty reduction led to the emergence in the 1970s of

proposals for promoting more labour-intensive activities, providing greater access by the poor to productive assets (through land reform, access to credit, etc.) and enhancing the coverage of education and health services to include the poor, so that gains from economic growth would be shared among members of the entire population. It was believed that economic growth would become more sustainable with a more equitable income distribution and higher levels of human development. This change in approach was strongly promoted by international organizations, including the International Labour Organization (ILO) and the United Nations, and embedded in "redistribution with growth" strategies, the World Employment Programme and the basic needs approach to development. However, these approaches, while appealing, did not become dominant policy practice in the 1970s or the 1980s.

Back to trickling down

Instead, following the developing-country debt crisis of the early 1980s, the Washington Consensus, together with a renewed focus on aggregate growth objectives, became the new paradigm, according to which market reforms would enhance economic and allocative efficiency and accelerate output growth for employment generation. Social policies also underwent substantial changes. The previous widespread use of subsidies and social transfers was seen as market-distorting and too costly, resulting not only in unsustainable fiscal deficits but also in ineffective delivery of education and health services. Subjecting social services to a greater extent to market principles (for example, through privatization or the introduction of user fees) would provide greater incentives for efficient service delivery and reduce pressures on Government budgets. Recognition that macroeconomic stabilization and structural adjustment programmes could, in the transition, incur social costs led to the introduction of social safety nets targeted to the poor and vulnerable. Within this framework, the key objective of social policies was no longer to serve a broader development strategy, but to offer up compensatory schemes devised to mitigate painful outcomes of market-oriented economic policies: There was a shift from universalism to selectivity.

A renewed focus on poverty reduction

Through the articulation of the Millennium Development Goals, following the adoption of the United Nations Millennium Declaration, and the decision to put Poverty Reduction Strategy Papers (PRSPs) at the centre of debt-relief initiatives for the poorest nations, poverty reduction and human development were repositioned more explicitly at the forefront of the development effort. Although market reforms and liberalization remained the mainstay of public policies, under these umbrellas, some policy shifts became more visible in the social arena, entailing greater priority for education and health spending, the revisiting of user-fee schemes, the promotion of programmes believed to reduce poverty, for example, in microfinance and land titling, and the introduction of innovative cash transfer programmes, which provided incentives to poor and vulnerable populations to invest in human development by making receipt of the transfers conditional on keeping children in school and/or on use of health facilities by mothers and children. Yet, in many instances, it proved difficult to repair the damage caused by market liberalization, and social policies remained largely marginal to economic policies. Macroeconomic policies, for instance, remained

narrowly focused on stabilization of price levels, government budgets and current-account deficits instead of on stabilization of employment. This not only limited scaling up of Millennium Development Goals-oriented public spending but also exacerbated the impacts of external shocks on employment and income growth, causing increased economic insecurity and placing a larger burden of adjustment disproportionately on the poor and vulnerable. Similarly, trade and financial policies remained committed to further integration with global markets, enhancing competitiveness and growth objectives, but in most instances yielding few benefits in terms of employment creation, poverty reduction and enhancement of economic security.

The way forward

As a result, many countries are not on track to achieve the Millennium Development Goals by 2015, the deadline set by the international community. But even should these Goals be achieved, significant human development challenges would remain: millions would still need to be lifted out of extreme poverty, and important educational needs extending beyond access to primary schooling and the high prevalence of acute and chronic diseases would still need to be addressed. These challenges will need to be dealt with in the context of persistent food insecurity, the threat of climate change, population ageing and other demographic shifts. When placed in today's context, the more successful development experiences suggest that the way forward would start with designing national sustainable development strategies tailored to country-specific conditions, the pursuit of coherence across key policy areas, and the recognition that:

- There is a need for a broad, development-oriented approach to macroeconomic policies, based on counter-cyclical fiscal and monetary policy rules supportive of employment creation and protection of household incomes during economic fluctuations, as well as on policy principles that ensure that aggregate price levels and resource flows are consistent with industrial policy incentives promoting economic diversification and sustainable development of the agriculture, forestry, energy, manufacturing and services sectors.
- Agricultural development policies — focusing on access to land, extension services, improved inputs, credits and rural infrastructure for farm smallholders — should be given high priority, especially in countries still facing low agricultural productivity.
- The demands of sustainable development will need to become a main focus of social and industrial policies and the choice of infrastructure and the setting of industrial priorities (not only for manufacturing, but also for agriculture, forestry and energy) will need to be consonant with meeting, simultaneously, the challenges of climate change adaptation and mitigation, sufficient job creation and improving the livelihoods of the poor.
- Social policy itself needs to be coherent, in the sense of avoiding too narrow a focus on social protection and targeting of the poor, and leaning more towards universalism (creating a "social floor" for people of all ages), and ensuring conditions for continuous progress in human development and for household-level social reproduction.

Effectively implementing such strategies will not be feasible without an enabling global environment. National development strategies will need to be supported by stable aid flows, especially for low-income countries with limited access to other sources of financing; by a fair multilateral trading regime allowing the countries space for building domestic production capacity and pursuing sustainable development goals; and by stable and predictable international financial markets. Such coherence between the national and the international arenas of policymaking is not present under today's rules and mechanisms for global governance. Major reforms of the existing international aid, trade and financial architectures are needed.

Towards a new aid architecture

Origins of a fragmented aid architecture

Originally, official development assistance (ODA) had been intended mainly to overcome foreign-exchange constraints on successfully implementing growth strategies. Large shares of bilateral and multilateral aid resources were destined to finance investment in infrastructure. Aid programmes of the 1950s and 1960s had further emphasized technical cooperation and capacity-building. Most, if not all, aid flows were to support Governments in their developmental efforts. This changed in subsequent decades, because of changes in both donor and recipient countries. In some recipient countries, problems of absorption and insufficient governance capacity to manage large aid inflows led to underutilization of foreign assistance. Other countries gained access increasingly to alternative external funding sources, thereby reducing their need to rely on ODA which often came with many strings attached. Donors, for their part, perceived that capacity-building was not taking root in many contexts and increasingly lost confidence both in aid's effectiveness in accelerating aggregate growth and in the ability of recipient Governments to manage aid flows. This loss of confidence in the role of Governments was compounded by the paradigm shift in development policies in the 1980s which resulted in the call for a less activist role for the State. Multilateral development financing became increasingly conditioned on fiscal consolidation, other macroeconomic stabilization measures and market reforms to be enacted by recipient Governments. Bilateral aid often followed suit, especially if aligned behind International Monetary Fund (IMF) and World Bank loan agreements. At the same time, increasing concerns about the social costs of adjustment led to a shift in the focus of aid towards poverty reduction and social programmes, while support for infrastructure (also among the multilateral development banks) was cut back.

In all, aid became much more narrowly focused on poverty programmes and social sectors and moved away from supporting broader, transformative development processes. The shift has also given rise to an enormous proliferation of aid agencies — governmental and non-governmental, multilateral and bilateral — which provide support and resources to developing countries for a multitude of specific-purpose aid projects. Most recently, the expanding roles of private foundations and donors from the South have contributed to this proliferation.

A highly fragmented aid architecture has emerged as a result. This has raised transaction costs and undermined national policy space. Each donor tends to undertake its own identification missions, negotiate the terms of the projects to be sponsored, impose its own accounting methods, define its own conditions, and

conduct its own monitoring and evaluation. This not only increases the direct cost of providing aid but also tends to affect the institutional capacity of recipient countries, which complicates the pursuit of coherent, long-term development policies by Governments. Aid fragmentation has also rendered the flow of resources less predictable and more volatile, thereby making the management of budgetary processes highly dependent on aid flows all the more challenging.

Fragmented — and insufficient — aid

A proliferation of donors does not necessarily mean more aid. The average size of aid programmes has become smaller. The major providers of ODA, united in the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), had contributed about 0.33 per cent of their combined gross national income (GNI) in 1990. This share fell to 0.22 per cent in the late 1990s. By 2010, it was back up to 0.35 per cent, but still fell well short of all existing commitments, including the long-standing United Nations target of 0.7 per cent of GNI.

The delivery gap in respect of fulfilling the commitments to support the Millennium Development Goals development agenda has become all the more poignant with the calls for additional assistance to the poorest countries in addressing their food security problems and climate change. Meanwhile, in many countries, aid flows have been overtaken by other resource flows, including FDI and worker remittances (figure O.4). Delivery gaps in aid commitments are largest for Africa, reflecting the continuing unevenness in the distribution of aid flows which does not strongly favour low-income countries.

These trends raise questions not only regarding the sufficiency of aid, but also about whether the aid that is being delivered is sufficiently aligned with the development financing requirements of the countries most in need of ODA.

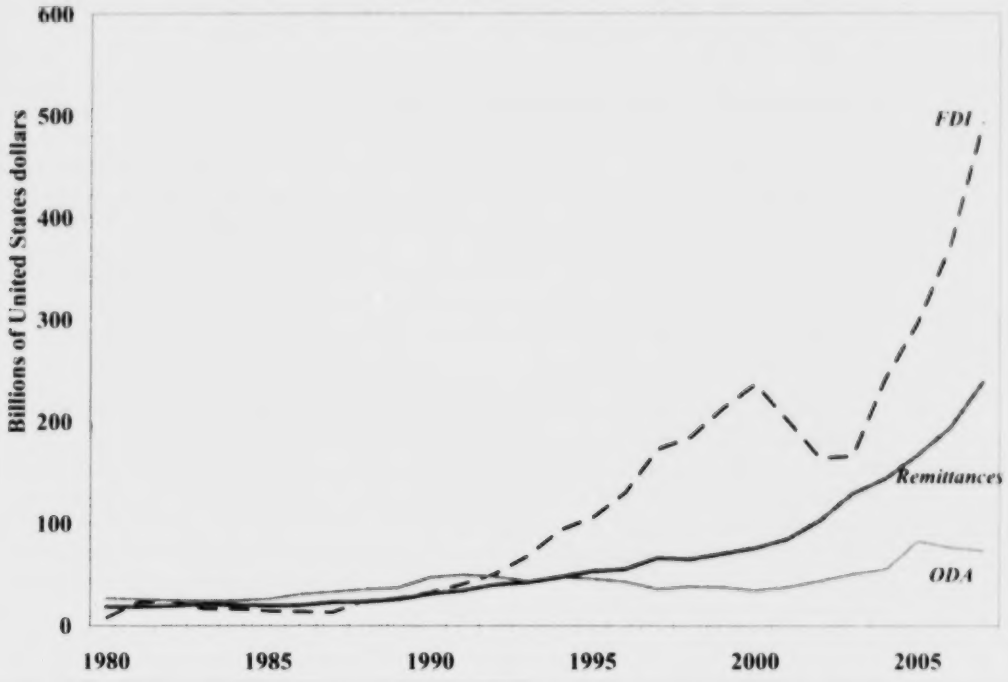
Addressing fragmentation: cures or just Band-Aids?

Donors have been trying to mend the situation. The 2005 Paris Declaration on Aid Effectiveness and the 2008 Accra Agenda for Action[1] have called for greater coherence in aid objectives and for accelerating implementation of agreed principles. The Paris Declaration provides new codes of conduct for donors which aim to reduce fragmentation, and includes targets for harmonization of aid flows aligned behind recipient-country programmes, coordination of donor missions, and reduction of project implementation costs. The quality of aid is to be enhanced by more predictable aid flows programmed at the country level. These efforts at greater coherence are also consistent with the PRSP agenda which ostensibly also aimed to put recipient countries in the driver's seat by aligning donors behind nationally defined development strategies.

Efforts to put these principles into practice have not proved easy. Reconciling national development priorities with the taxpayer-approved objectives of donor countries has been difficult.

[1] A/63/539, annex.

Figure O.4
Flows of foreign direct investment (FDI), remittances and official development assistance (ODA) to developing countries, 1980-2007



Sources: Organization for Economic Cooperation and Development/Development Assistance Committee and World Bank.

Less than one quarter of aid flows from DAC donors is provided in the form of budget support and in few instances are aid flows part of multi-annual programmes. In practice, the PRSPs have been perceived as coming with too many strings attached, including macroeconomic policy conditions, and as being donor-driven, effectively undermining country ownership of aid programmes and increased donor alignment behind national development strategies.

The way forward: towards a needs-oriented aid architecture ...

Even if attempts so far have not yielded much outright success, putting recipient countries in the driver's seat would seem to constitute a desirable step on the road towards less fragmented and more effective aid delivery. What is needed is a much stronger commitment by donors to accepting the principle of needs-based allocations and alignment of aid flows behind national development strategies, which is consistent with the principles of the Paris Declaration. Rather than the gradual improvements that are currently being attempted, a more radical shift towards full adherence would seem to be needed in order to overcome continued

fragmentation and problems of country ownership which undermine aid effectiveness.

Under this approach, sustainable development strategies would provide the framework for policy coherence at the national level and also determine the nature of the financing gaps to be filled by aid flows and the timing required. Bilateral and multilateral as well as non-governmental donors would be aligned and asked to respond to needs through multi-year commitments. Alignment with other sources of development financing could occur as part of the same process (see below). Earmarking of aid funds by donors would become less relevant, although still possible if it served to further specific purposes (as in the case where private sector support would be rallied through vertical global health funds), but such earmarking would always be required to demonstrate its coherence with the priorities and financing needs of the development strategy. Monitoring, evaluation, accountability processes and the updating of funding requirements would be the responsibility of a joint standing committee made up of donors but chaired by the recipient country. Ex ante conditionality would be restricted to recipient countries that had elaborated national development strategies but donors would not attach further policy conditions to their support; instead, the decision to continue support would be based on monitored progress and the outcomes of the implemented strategy.

... with new sources of financing channelled through country-owned trust funds

While the present target of 0.7 per cent of GNI of OECD/DAC countries, set on the basis of estimated foreign-exchange needs of developing countries in the 1960s, has remained unfulfilled in the aggregate, a needs-oriented aid system would probably redefine the amount of aid that needed to be mobilized. Additional targets may need to be set to ensure sufficient resource mobilization for supporting climate change mitigation and adaptation efforts in developing countries, aid for trade and the delivery of global public goods. There will also be a continued need for separate pools of funds for disaster relief and humanitarian aid efforts.

Two further fundamental changes should be considered. The first would aim at better alignment of aid flows with other domestic and external sources of development financing through the use of trust fund mechanisms. The second would entail the increased use of innovative forms of international levies and leveraging of international liquidity for development purposes.

The use of trust fund mechanisms to support individual countries or groups of countries could further facilitate the alignment of donor funding with country priorities, ensure long-term financing, and align traditional ODA resource mobilization with innovative forms of development financing. Bilateral donors and existing global funds would contribute to trust funds which would disburse resources in accordance with the programmatic and budgetary needs of recipient countries. The trust funds could also be allowed to purchase Government securities of developing countries in order to tie aid to future domestic resource mobilization efforts. Experience does exist in this area, as there are a number of cases where multi-year aid commitments have been converted into bond purchases to fund and frontload resources for tropical medicines. Recipient countries, in turn, could also be allowed to periodically deposit budgetary savings earned during economic

upswings into the trust funds as insurance against external shocks, and to draw upon them in response to shocks. Another advantage of pooling aid resources in a trust fund is the simplification and harmonization of procedures, and better support of national goals, priorities and strategies. It can prevent duplication and overlapping effects and minimize the burden of integrating aid within recipient institutions. However, the ownership and management mechanisms of trust funds need to be carefully worked out so that country ownership is not undermined. The pledges of funds should not be conditional or earmarked.

New forms of international levies (such as a small levy on international financial transactions) could play an increasing role in providing the resources for a new development finance architecture. The new tax revenues could be channelled via a global fund to country-based trust funds.

Revisiting global trade rules

Present rules insufficiently adhere to the common-but-differentiated principle

The impasse over the Doha Round, launched in 2001 and aiming for more development-oriented multilateral trading rules, reflects the difficulty of striking a proper balance between a desired common set of rules of the game and the principle of accommodating different capacities among countries to competitively engage in trade. The common-but-differentiated approach has been part of the process of designing multilateral rules and strengthening international cooperation ever since the establishment of the General Agreement on Tariffs and Trade (GATT).

Since the establishment of the World Trade Organization, the main emphasis has shifted towards setting common trade rules, as reflected in the trade liberalization that has taken place worldwide over the past two decades. This has progressively restricted the space available to developing countries for utilizing trade policies to foster economic development.

There has been progress in providing developing countries, especially the least developed countries, with greater duty- and quota-free access to developed-country markets for their products through the application of the most-favoured-nation treatment. Yet, important barriers to market access persist for developing countries. Also, agricultural subsidies in advanced countries remain high and continue to limit production and income opportunities for farmers in developing countries.

Creating more space for trade and industrial policies

Countries that have been successfully integrated into world trade over the past half-century all went through stages of trade protection and support to domestic production sectors before opening themselves up to world markets. Present multilateral trade rules leave limited space for newcomers that wish to follow in their footsteps. While further progress needs to be made in enhancing world market access for developing countries and reducing agricultural support measures in developed countries, multilateral rules will need to be recalibrated in order to

increase the space available to developing countries for building production and trading capacity.

One key action will be to revisit the current rules limiting the use of subsidies for export promotion. Developing countries should be given more space for applying these subsidies as part of their broader development strategies. To ensure consistency with the common-but-differentiated approach, allowing for the use of such subsidies should be conditioned on their being truly selective (not across-the-board), temporary (not open-ended), performance-related (not unconditional), consistent with the decent-work agenda, and environment friendly (see below).

A second key action is to significantly expand the Aid for Trade initiative. Resource allocation under Aid for Trade would need to be fully aligned with national development strategies. Aid for Trade emerged as a separate initiative within the context of trade negotiations, designed to compensate for the loss of production, trade and government revenues, as well as to support developing countries in developing an internationally competitive production structure and trade capacity and capabilities.

Trade and climate change

Achieving coherence between trade and climate policies is a recently recognized challenge. In the absence of corrective measures, trade that is more open will likely lead to increased greenhouse gas emissions (for example, those generated through transportation of goods). Conversely, climate change is already affecting the production and trading capacity of some developing countries, inter alia, through the impact of the increased intensity of natural hazards on agriculture and infrastructure.

Furthermore, national policies designed to address climate change may affect world prices and production, trade and livelihoods in other parts of the world. Domestic price subsidies to stimulate biofuel production in Europe and the United States of America, for instance, have impacted on land use, contributed to world food prices' drifting upward and caused increases in poverty in large parts of the developing world.

More generally, at present there is no level playing field in terms of the capacity of countries to conduct national climate change policies, which will have implications for international competitiveness. For instance, countries lacking resources and affordable access to carbon-efficient technologies possess a competitive disadvantage compared with those that are able to support industries in meeting climate change mitigation targets, inter alia, through duties levied on the basis of the carbon content of products imported from countries not undertaking comparable mitigation efforts. In this way, climate-trade links would be used as a basis for protectionism.

In addition, existing multilateral trading rules constitute hurdles to technology transfers to developing countries. Such obstacles also make the development of industries using green technologies more expensive. Conflicting elements in World Trade Organization rules and multilateral environmental agreements, including the United Nations Framework Convention on Climate Change,[2] are also a source of many tensions.

[2] United Nations, *Treaty Series*, vol. 1771, No. 30822.

Greening global trade and access to technology

A first priority for achieving greater coherence between trade and climate policies will be to resolve the conflicts between multilateral trading rules and multilateral environmental agreements. This will be most urgent in respect of addressing the threat of climate change. Climate objectives should be given primacy when aligning a multilateral climate accord with multilateral trading rules, since the sustainability of material welfare is conditioned by climatic conditions. The alignment should also be consistent with the principle of common-but-differentiated responsibilities underlying multilateral climate accords.

In the area of subsidies, tariffs and environmental standards, action needs to be taken to prevent climate-related border adjustment measures from becoming the basis for protectionism and distorting the level playing field for fair trade relations.

The Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS Agreement)[3] will need to be revisited to allow for the affordable transfer of technologies to developing countries so as to enable them to adapt low-carbon and energy-efficient production methods. To further ensure a level playing field in the area of policies supporting green production, compensatory schemes will have to be established to cover the incremental costs of introducing cleaner technologies in developing countries.

Tax coordination and global value chains

The predominance of global value chains in international manufacturing and trade has motivated developing-country Governments to provide tax and other incentives to multinational companies in order to attract foreign investment and gain access to these chains. Quite often, there is a tendency to engage in "beggar thy neighbour" tax incentive competition, resulting in a race to the bottom. Tax incentives, however, are not prime movers in respect of decisions on production location made by multinational companies. As a result, Governments tend to lose out on significant tax revenue.

Strengthened international tax cooperation could prevent such tax competition. Tax cooperation should also reduce the scope for the use of transfer-pricing practices by multinational companies which, in order to evade taxes, value intra-firm transaction in such a way as to enable higher profits to be accounted for in locations where taxes are lowest. Effective international tax cooperation may yield significant additional resources for development, possibly exceeding by some margin the present level of annual flows of development assistance.

Regional versus multilateral trade agreements

Discrepancies between the multilateral trading framework, on the one hand, and proliferating economic partnership agreements as well as bilateral and regional free trade agreements, on the other, represent another source of policy incoherence.

[3] See *Legal Instruments Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations, done at Marrakesh on 15 April 1994* (GATT secretariat publication, Sales No. GATT/1994-7).

Consequently, multilateral discipline regarding free trade agreements and economic partnership agreements needs to be strengthened. At the same time, the negotiation capacity of developing countries adhering to free trade agreements and economic partnership agreements will need to be strengthened. Trade-related technical assistance continues to be inadequate and needs further expansion. Also, in the World Trade Organization, where countries are equal, not all members have the capacity to participate in all negotiations with full-strength teams. Countries whose resources are inadequate for obtaining and utilizing the information required for their engagement in World Trade Organization-related activities need assistance.

Refocusing the World Trade Organization

Through the establishment of the World Trade Organization, there emerged the first international enforcement system in economic matters. The dispute settlement mechanism of the World Trade Organization sanctions retaliation through trade measures. It has also encompassed a significant proliferation of multilateral disciplines covering a variety of so-called trade-related issues subject to this legal enforcement weapon. Most of these trade-related issues — especially intellectual property rights, investment measures, and trade in services (particularly financial services) — are of greater direct interest to developed countries. Difficult negotiations over trade-related issues have burdened the World Trade Organization's decision-making machinery and, in effect, have expanded its agenda and extended it into areas that would probably belong more properly within the purview of other agencies.

Coherence in global governance may require rethinking the scope of World Trade Organization disciplines. For instance, the financial crisis has highlighted the pressing need for better international financial regulation and better instruments for countries' management of capital flows. These regulatory needs create tensions with the General Agreement on Trade in Services,[4] which aims at easing cross-border financial services flows (Modes 1 and 2). Such inconsistencies can be avoided by defining multilateral rules on trade in financial services as part of a reformed international financial regulatory framework looked after by a specialized body (see below). Similarly, the complexity of regulatory needs regarding cross-border movements of people could justify the consideration of a separate multilateral framework for consular practices and immigration laws so as to create a transparent and non-discriminatory system of migration for people who wish to move, temporarily or permanently, across borders.

Making dispute mechanisms more equitable

Enforcement mechanisms for trade commitments have to be made more equitable. Serious deficiencies remain at every stage of the World Trade Organization dispute settlement process. Given the substantial cost, poorer nations are deterred from bringing cases into that process. Retaliation is the only possible sanction. Since all economic sanctions are costly to the initiator, a poor country's ability to impose a sanction on a rich one is much more limited than that of a rich country seeking to impose a sanction on a poor one. Ensuring the viability of the

[4] Ibid.

World Trade Organization process and its enforcement mechanism in the long term requires the counteracting of existing biases. In domestic litigation, legal aid is used to provide the poor with better access to justice which is costly: the injured party is awarded its costs by the court while centrally organized sanctions spare the injured party from having to bear all the costs of punishing the violator. Analogously, the inclusion of compensatory mechanisms in the World Trade Organization dispute settlement process could introduce greater justice into the enforcement of multilateral trading rules.

Reforming the international financial system

Fundamental weaknesses in the international financial system played a key role in the current global economic crisis. Financial deregulation and lifting of capital controls in most countries had supported greater global financial integration during the 1990s and 2000s. It also facilitated the move of financial innovation into the area of new, complex derivatives and the increased distancing of financial instruments from more tangible and productive assets. This fed a rapid expansion of short-term capital movements. Financial markets also became increasingly interwoven with insurance, commodity and real estate markets through complex instruments that could be easily transacted internationally. In large part, this process of "financialization" expanded beyond the control of regulators. In addition to fostering an illusion of asset diversification, the system promoted excessive risk-taking and asset inflation bubbles which stimulated what proved to be an unsustainable pattern of global economic growth. Unregulated financial expansion also fed pro-cyclical capital flow volatility and speculation in commodity markets. The latter played some role in the fuel and food crises.

The central function of a financial system is to intermediate efficiently between savers and investors and to provide reliable and adequate long-term financing for investment. Financial growth of the past decades clearly lost track of that function. The rate of (productive) investment stagnated in most parts of the world, despite the explosive growth in finance (figure O.5). Greater capital mobility has given developing countries greater access to financial resources, but it has also made macroeconomic policy management more challenging because of the volatile and boom-bust nature of financial flows in deregulated markets.

In today's world of increased economic and political interdependence, achieving a broad-based, rapid and sustained growth in employment and incomes involves even more complex policy challenges than those of the past. The multilateral arrangements designed at Bretton Woods did not include a global regime for capital movements, as capital mobility was expected to be limited. However, even after the breakdown of those arrangements, and despite the surge in private capital flows, no such regime emerged. Clearly, a renewed Bretton Woods system will be needed to help both developed and developing countries mitigate the damaging effects of volatile capital flows and commodity prices.

Figure O.5
Rapid financial growth but stagnant fixed investment, 1970-2008

Source: Department of Economic and Social Affairs of the United Nations Secretariat, based on United Nations Statistics Division, National Accounts Main Aggregates; and International Monetary Fund, *International Financial Statistics*.

Strengthening international financial cooperation

A number of options are available for creating a more stable financial system and a better environment for sustainable growth. Some are being addressed as part of the responses to the 2008-2009 global crisis, but probably all will need to be adopted and, simultaneously, to bring about the desired outcome.

First, improved international financial regulation is needed to stem excessive risk-taking and capital flow volatility, including through appropriate capital controls and macro-prudential regulatory reforms imposing counter-cyclical biases in rules for reserve requirements and loan-loss provisioning.

Second, strengthened international tax coordination and lifting of bank secrecy are needed for comprehensive financial regulatory and supervisory reforms so as to ensure that oversight extends to offshore banking centres which currently are unregulated and operate as tax havens.

Third, as new systems of regulation are being elaborated, there is a need for a fundamental revision of existing mechanisms of compensatory financing designed to cope with external shocks. Such revisions should ensure more adequate availability of and easier access to international liquidity, especially for developing

countries, by modifying the terms of access to such resources along the lines of recent reforms of IMF credit facilities but with a further easing of access, especially for low-income countries, through alignment with national development strategies and new aid modalities, as proposed above.

Fourth, multilateral surveillance will need to be revised so as to include within its purview all possible international spillovers of national economic policies. Surveillance for crisis prevention and safeguarding of global financial stability remains a key responsibility of IMF, which has centred its efforts on external stability and exchange-rate assessment. It did not prove effective in preventing the recent global crisis, in part because the existing mechanism did not differentiate among countries in terms of their influence on systemic stability — that is to say, surveillance was not more rigorous for countries issuing major reserve currencies. Such differentiation should be an essential part of surveillance; but, more importantly, perhaps it should be embedded in a strengthened and institutionalized mechanism for coordinating macroeconomic policies internationally. As the crisis has made clear, such a mechanism is needed in order to moderate swings in the global business cycle and address the problem of global financial imbalances. The promise of the Group of Twenty (G-20) to establish a framework for generating strong, sustainable and balanced world economic growth should be fleshed out and operationalized urgently. However, as sustainable rebalancing of the world economy will take many years, the implementation of such a framework cannot be left to informal consultations at the level of the G-20: it will require proper institutionalization within the multilateral system and establishment of enforcement mechanisms to make policy coordination effective and accountable.

Fifth, a new global reserve system could be created, one that no longer relies on the United States dollar as the single major reserve currency. The dollar has proved not to be a stable store of value, which is a requisite for a stable reserve currency. Nonetheless, motivated in part by needs for self-insurance against volatility in commodity markets and capital flows, many developing countries accumulated vast amount of such reserves during the 2000s. Hence, a new system needs to be developed. That system should allow for better pooling of reserves at the regional and international levels; it must not be based on a single currency or even multiple national currencies but, instead, should permit the emission of international liquidity (such as SDRs) to create a more stable global financial system. Such emissions of international liquidity could also underpin the financing of investment in long-term sustainable development, as suggested above.

Reforming governance of the international financial architecture

None of these reforms will work effectively, however, if the democratic deficit undermining the credibility of the Bretton Woods institutions is not repaired. The governance structure of IMF and the World Bank must be reformed so as to more adequately reflect changes in the weights of actors in the world economy, and to be more responsive to current and future challenges, thereby strengthening the legitimacy and effectiveness of these institutions. It is important not only to rebalance voting power in these institutions but to fundamentally restructure their functions and to equip them with the resources necessary to enable them to effectively safeguard global financial stability, coordinate macroeconomic policies and provide adequate long-term development financing.

A new multilateral agency would need to be created to enforce the rules to be established for better and more comprehensive international financial regulation and supervision. Existing institutions, such as the Basel Committee on Banking Supervision and the Financial Stability Board, are too limited in terms of the scope of their functions and instruments and they lack sufficient representation. The new multilateral financial authority would also need to ensure coherence between the global financial regulatory framework and multilateral trade rules.

Is fair and sustainable globalization feasible?

The present set of institutions and rules for managing the world economy were established more than 60 years ago together with the founding of the United Nations and the creation of IMF, the World Bank and the General Agreement on Tariffs and Trade (GATT). Since then, the world has changed beyond recognition, while, in contrast, institutions for global governance have changed little or have adapted slowly. National economies have become ever more closely integrated through trade, investment, finance, international migration, and the technological revolutions in transport and communications.

It is clear that development outcomes in the twenty-first century will be shaped, to a large extent, by the international context. It is also clear that the inequities, both in formal terms and in practice, in the ground rules operating throughout the world economy is unduly restricting the policy space essential for promoting development. This year's *World Economic and Social Survey* argues that there is a need to eliminate inconsistencies in multilateral rules-setting related to different spheres and to international versus national objectives. This can be achieved through progress in achieving the following key actions:

- Empowering national authorities to deploy a much broader range of development policies than those implemented in the last two decades through reform of aid mechanisms, international trade disciplines and financial regulations
- Significantly expanding the access of developing countries to technology so as to render it comparable with the access provided to the international trade in goods
- Establishing just, predictable and comparable regulatory regimes to facilitate the international movement of both labour and capital
- Institutionalizing counter-cyclical macroeconomic coordination through reforms in surveillance mechanisms and the global payments and reserve system
- Achieving effective coordination in financial regulation and tax cooperation, which will require abandoning the self-defeating State competition over foreign investment flows that has gone on for years
- Averting the threat of climate change through globally coordinated action, which will require adjustments, through the aid, trade and financial architectures, in rules-setting and priority-setting so as to make them coherent with global sustainable development objectives

Retooling the rules of the game for a fair and sustainable global development is necessary, but not sufficient, for retooling is also about the players. Providing

developing countries having weaker initial conditions with more time, resources and policy space for becoming full participants is not to be regarded as an act of charity or goodwill on the part of the powerful but as an imperative for realizing the shared goal of expanding international commerce. The principle of common-but-differentiated rights and obligations defined as a function of level of development will need to be applied in practice and embedded within a system of clear rules.

Reshaping rules is easier said than done. Players will need to agree on the common global sustainable development goals to be pursued and will need to be convinced that cooperation will provide net benefits for all — benefits serving present and future generations. However, within any scheme of international cooperation, net benefits may be perceived as not being equal for all; and any expected unevenness in outcomes may impede the reaching of effective global solutions. Because of differences in living standards, and therefore in capacity to pay, some countries will be expected to shoulder larger shares of the total costs of providing global public goods, which may reduce their incentive to cooperate in providing them. Hence, with respect to establishing multilateral agreements, the proposed pattern of burden-sharing is as important as the extent of the benefits to be conferred by the public goods.

The international community must face a key fact, namely, that the pattern of uneven development brought about by globalization so far has been sustainable neither economically nor environmentally, nor has it been feasible politically. As this time around, developing countries are much more significant and much better integrated into the world economy, the global crisis has profounder implications and more serious consequences for development

While the present crisis only highlights the ever-present risks associated with the deeper integration of national economies into the world economy, the issue concerns not so much a retreat from globalization, although in quantitative terms the current crisis is forcing such a trend, as a feasible reshaping of the globalization process. The proposed means of retooling the existing aid, trade and financial architectures aim at overcoming present shortcomings. It is equally important to overcome institutional shortcomings in current decision-making in the key organizations of global economic governance, such as IMF and the World Bank, and to eliminate inequities in respect of the access to participation in other organizations, such as the World Trade Organization.

There is a need to strengthen the global coordination of economic decision-making so as to minimize the number of cases where rules dealing with trade, aid, debt, finance, migration, environmental sustainability and other development issues come into conflict. At present, there is no international agency dealing systematically with questions of coherence and consistency in multilateral rules-setting. Although, in 1995, it was proposed that a reformed United Nations Economic and Social Council exercise this directive role, the proposal received only modest support at the time.

The global crisis has provided painful evidence of the weaknesses of the present system. The issues of climate change and demographic changes demand even greater coherence among the spheres of global governance and between decision-making processes at the global and national levels. Whatever its shape, the foundation to be established for international coordination based on shared principles and transparent mechanisms is more urgently needed than ever.